2012-04-30

Competing into the Future: Responding to the Emerging Challenges of MNC Subsidiaries

Marty Reilly
Technological University Dublin, reillymarty@hotmail.com

Pamela Sharkey Scott
Technological University Dublin, pamela.sharkeyscott@tudublin.ie

Vincent Mangematin
Grenoble Ecole de Management

Recommended Citation

Reilly, M., Scott, P., Mangematin, V. (2012, forthcoming), Competing into the Future: Responding to the Emerging Challenges of MNC Subsidiaries, Journal of Business Strategy

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Abstract

Purpose
Subsidiary units must respond to emerging threats including disaggregation of value chains and increased headquarters monitoring and control which have lead to a *cycle of subsidiary decline*. We recognize the value of subsidiary initiatives as a short term response but argue that subsidiary long term survival and growth will depend on the unit's ability to align with its parent strategic activities and knowledge base.

Design/ Methodology
This research is part of an ongoing quantitative and qualitative study programme of Irish subsidiary operations of foreign MNCs. This paper integrates our broader research to date with both in-depth interviews of a focal case with a comprehensive review of the literature relating to MNC and subsidiary management to identify how subsidiaries can respond to current challenges.

Findings.
In contrast to the dominant view in the literature, our research found that subsidiaries can respond to emerging threats by integrating their activities and deepening their alignment with their parent operation. We identify three significantly important features in developing alignment – *strategic embeddedness* or ensuring development of subsidiary strategy in line with headquarters stated objectives, *relational embeddedness* determined by trust relationships and a history of consistent subsidiary delivery and finally *knowledge embeddedness* facilitated through coalescent knowledge creation and collaborative effort in line with headquarters strategy and direction.

Research Limitations.
Results from the survey are subject to the standard limitations and a larger pool of interviewees may have reinforced the qualitative findings.

Practical Implications.
Subsidiary managers need to be aware of how closer integration of unit activities with headquarters and the management of knowledge outflows can reduce the risk of relocation and better position subsidiaries for survival and growth.

Originality.
By demonstrating the benefits of alignment with headquarters, this paper provides a valuable alternative perspective to the predominant view in the literature that subsidiary survival is dependent on subsidiary initiative. Capturing both the subsidiary and parent perspectives addresses a significant limitation of many studies and provides valuable insights.

Keywords

MNC Subsidiary
Initiative
Alignment
Combinative capabilities

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The subsidiaries of multinational corporations (MNC) constantly face the very real threat of closure and transfer of operations to lower cost economies. Both the practitioner and academic press identifies how some subsidiary units have eluded this outcome by acting on local opportunities to develop strategic initiatives. Headquarters (HQ) can then exploit these initiatives across its subsidiary units leading to competitive advantage for the organisation and enhanced influence and legitimacy for the initiating subsidiary. At a global level organizations such as *Google* have traditionally provided exemplar cases of organizations which encouraged and embraced a culture of entrepreneurship and initiative taking across all of its business units. As a result, many subsidiaries are constantly urged to be entrepreneurial and develop initiatives as a means of protecting from relocation, accessing organisational resources, and building capabilities.

We are currently undertaking a multifaceted project combining extensive literature searching, several series of interviews with directors and middle management of major subsidiaries, and in some instances their headquarters, and large surveys targeted at the total population of Irish subsidiaries (see Box 1, How the Research was Conducted). As a small, open economy on the edge of Europe, with a long history of attracting significant Foreign Direct Investment from MNCs, Ireland is a particularly appropriate location for researching trends in subsidiary dynamics. Earlier output from our research, published in this journal identified how the erosion of barriers of trade, growing complexities in corporate governance and developing ICT capabilities are enabling HQ's to disaggregate value chains across and outside the organisation, reducing its reliance on individual subsidiary operations. In addition, more sophisticated ICT supports greater subsidiary monitoring and control, reducing a unit's ability to differentiate its activities and to generate initiatives. Our earlier paper in this journal demonstrated how these trends can interact to create *a cycle of subsidiary decline*. A diminished ability to negotiate with HQ leads to less resources resulting in a deterioration in subsidiary combinative capabilities and the ability to use locally based knowledge and opportunities to generate initiatives, further undermining its ability to negotiate with HQ.

In line with the dominant view in the subsidiary literature (Birkinshaw, 1997; Bouquet and Birkinshaw, 2008; Rugman and Verbeke, 2001) we acknowledge the contribution of subsidiary initiative in breaking the *cycle of subsidiary decline* and rebuilding subsidiary bargaining power. From an MNC perspective independent subsidiary initiative can be replicated across the organisation with beneficial effects. However, insights from integrating our ongoing research, and in particular drawing on the experiences of a global organization as outlined in Exhibit I, prompt us to suggest that focusing on the relatively short term benefits of initiative has overshadowed the potential long term value of subsidiary *alignment* with the parent unit. We identified that subsidiary survival and growth regularly depends on the unit's ability to develop not a *unique* role, but an *active and integrated* role, that essentially straddles its parent operations. Greater integration with HQ's strategy and activities may be more important than generating unasked and possibly unwanted initiatives; there may be less value in being a 'maverick' initiator than both the academic and popular press implies.

Current challenges facing subsidiary units

To exploit the synergistic potential of the MNC, subsidiaries must build *combinative capabilities* (Scott and Gibbons, 2011). Knowledge may have little value in isolation but when combined within a framework the subsidiary can understand how it relates to other organisational activities, and how these activities relate to each other. The subsidiary's combinative capabilities not only enable the subsidiary to utilize its locally based knowledge and opportunities but also facilitates the generation of initiatives for exploitation across the organisation. We identify how the challenges confronting subsidiary units restrict both their flexibility and contributory potential before looking at how these potential challenges can be moderated. The direct implications of these challenges are presented here as distinct and separately identifiable for clarity, but in reality these outcomes collectively reinforce the emerging threats and drive further changes.

Disaggregated value chains -
The lines between which activities happen within the MNC and which activities are outsourced are blurring as value chains are increasingly sliced into often unconnected packages and allocated around the world, usually on a value for money basis. Slicing of activities into unrelated packages is a major departure from the traditional national subsidiary which operated as a miniature replica of its parent with cross functional activities enjoying a portfolio of inter-related activities and building up bundles of related supporting knowledge. Similarly to the guerrilla warfare approach of using cell structures to prevent leaking of information, unconnected activities from different value chains will lead to corals of disjoint information and knowledge. These unrelated nuggets of knowledge fail to provide a cogent indication of what *combinative competencies* the subsidiary needs to build to continue to add value and in turn to be a valuable element of the organisation. Just as Gestalt theorists emphasize the importance of integration, the ability to connect a combined package of activities is more valuable than knowledge of a sole component as 'the whole is greater than the sum of the parts'.

More specialized subsidiary roles –

The academic and popular press has largely concentrated on the positive aspects of disaggregating value chains, noting the emergence of 'centres of excellence' or 'subsidiary specific capabilities' with surprisingly less attention being paid to the negative implications on subsidiary sustainability. Over time subsidiaries may become marginalised from the organisation and its capacity to compete at a global level becomes restricted by their narrow focus. Subsidiary specific capabilities, once upheld as a collective source of value can become a burden or rigidity, narrowing the subsidiary's perspective of the MNC and its ability to contribute. Unrelated activities or rigidities will not only impact upon reducing the real and perceived flexibility of the subsidiary but also its capacity to be part of the next round of strategic development. It can simply become more appealing, from a parent perspective, to look to lower cost economies in the provision of future MNC mandates than to reconfigure existing subsidiary resources in current locations. Over time, as subsidiary units become increasingly more marginal - and terminable, to the core business, the cycle of decline gains momentum.

Increased competition within the MNC –

More outsourcing provides HQ with more options for scoping and locating in-house operations. This reduces reliance on specific units within the organization, eroding the value of subsidiary combinative capabilities and skills. Subsidiaries must also effectively compete not just against their sister subsidiaries but also against external competitors. HQ must be convinced that the benefits of future investments in a particular subsidiary's combinative capabilities are higher compared to not just investing in another subsidiary, but also to the outsourcing alternative. While this may be shortsighted from a long term organisational perspective in the short term allowing another organization to bear the knowledge development burden may be an attractive option.

Increased internal competition also inhibits collaboration and knowledge transfer between sister units, one of the key advantages of the MNC organization form (Ghoshal and Bartlett, 1988). As subsidiary management strive to get *the fruits of their labour* the safeguarding of local knowledge can create barriers to knowledge sharing further hindering collaborative effort. As such, Holm and Perdersen, (2000) remark that existing MNC networks may be more akin to political coalitions than the military like formations of the traditional MNC structures.

Responding to these challenges

From our interviews, a consensus emerged that alignment with HQ strategy and operations is critical to subsidiary long term survival and growth. *Consistency* with HQ strategy and *adherence* to parent driven objectives enables a subsidiary unit to establish a more interdependent relationship with HQ. We found that adherence and consistency are build through developing *vertical interdependencies* or ties between HQ and a focal subsidiary, achieved through formal and informal linkages. This facilitates the gathering of critical *internal intelligence* regarding emerging investment and resource allocation decisions. Similarly, the development of lateral interdependencies enables the collection of vital internal intelligence of the resources and capabilities in other sites, facilitating awareness of how internal units can collaborate and compete for precious value chain activities. It also provides valuable information regarding sister competitors for HQ attention and resources.

Greater subsidiary alignment encapsulates an ability to provide accurate and relevant knowledge that extends beyond the immediate subsidiary environment in aiding integrative and combinative solutions. Through formal and informal integrating mechanisms subsidiaries become more aware of the resources and capabilities in other sites facilitating greater coordination and the potential to build combinative capabilities. Integration is crucial to exploit the resources and capabilities within the MNC network through interacting and collaborating with other units in the network. To do this they must first build interdependencies.

Vertical interdependencies-

Barriers to knowledge sharing present a significant obstacle to building combinative capabilities in the modern MNC. If the synergistic potential of the MNC is dependent upon building combinative capabilities, then a subsidiary's network position will be largely contingent upon its capacity to closely coordinate efforts with other business units either within their internal environment or immediate external network. Previous research on subsidiaries has shown how the efficiency of the MNC as a knowledge integrating institution is driven by changes in both the subsidiary's context, its capabilities and its potential to process knowledge (Ambos, Ambos and Schlegelmilch, 2006). How this knowledge is processed and whom the ultimate benefactor is becomes increasingly important. Subsidiary managers must assure that the recipients of knowledge acknowledge their efforts and not merely engage in self promotion; limiting the potential benefits of lateral integration with peer business units. A need to manage knowledge flows becomes increasingly important. When the recipient of knowledge is their *de facto* controller this not only eases concerns of intra-subsidiary rivalry but also facilitates greater alignment and relationship building potential with the parent. Reverse knowledge flows, flowing from the subsidiary back to the parent have proved to contribute to greater alignment within the MNC (Gupta and Govindarajan, 1991).

The value of knowledge sharing across the organization is vital to MNC sustainable advantage. However, from a subsidiary perspective when knowledge or capabilities are disseminated within an organization they are no longer tied to a location and essentially lose the potential to enhance the subsidiary's value. Vertical interdependencies facilitate greater contact, interaction and frequency with HQ providing the subsidiary with greater insight into what's really foremost in terms of MNC objectives. It also provides an invaluable platform for subsidiaries to present and sell ideas which are favourable to subsidiary strategy to HQ. This allows the subsidiary to show compliance today whilst simultaneously positioning itself to be part of tomorrow's strategy. This does not mean that the subsidiary ignores local opportunities, but that these opportunities are viewed through a compliance lens and developed in line with existing strategy.

Interdependencies in practice – The Setanta Case

Setanta our illustrative case provides corporate communication solutions globally. Their activities incorporate a *follow the sun* operation in conjunction with their US parent, within the communications sector. Setup as a European market exploiting subsidiary in the late 1990s, *Setanta* has since increased headcount almost ten fold, established itself as a significant source of global initiative and established a fully integrated relationship with HQ. In attempting to understand how *Setanta* developed these vertical and lateral interdependencies interviews were conducted with both middle and senior managers in the subsidiary before gaining a parent perspective via senior directors (and the COO) in the parent. (see Box 1, ''How the research was conducted'').

Through integrating the case with our larger study we identified three integral factors to developing this relationship – *strategic embeddedness* or developing subsidiary strategy in line with stated and implied HQ objectives, *relational embeddedness* or ties built on trust and a tradition of exceeding expectations and objectives and finally *knowledge embeddedness* facilitated through coalescent knowledge creation and a tradition of collaboration in line with HQ strategy and direction.

Box 1. How the Research was Conducted

In response to the needs of both practitioners and policy makers, Dublin Institute of Technology undertook a major review of middle and senior management practices in Irish subsidiaries of foreign MNCs. Among the subsidiaries sampled an especial case facilitated access to both local subsidiary management and the US Headquarters top management team. This opportunity allowed us to examine subsidiary differentials from both the subsidiary perspective and that of the parent, overcoming the single respondent bias which dilutes the value of much of the current research on subsidiaries.

The focal organisation (referred to as *Setanta* for reasons of anonymity) provides corporate communication solutions globally and is currently listed on the NASDAQ. Their *follow the sun* operation dictates a high level of interaction between subsidiary units and headquarters, particularly during daily hand-overs of customer service activities.

In depth interviews with senior management from both the subsidiary unit and headquarters provided critical insights into how subsidiaries position for survival and growth. While the interview programme was set in the parent and host locations of one global organisation, the results are consistent with our broader exploration of subsidiary activities and add to our understanding of the increasing complexities of the operating environments of both headquarters and subsidiaries.

1) Strategic Embeddedness

In our broader programme of interviews it became evident that subsidiary based initiatives arise when a product, process or business is developed in response to a local opportunity. Often this was carried in response to local opportunity when the unit would develop a product in a secretive manner, in isolation, and without explicit approval from HQ. When an internal project had developed significantly and had demonstrable value to HQ it would then be 'sold' to the parent. In an illustrative example one subsidiary manager described how utilization of slack resources meant that the parent was largely unaware of initiative taking. The plant manager 'grew the capability and kept it under the radar until such a time as he could go to corporate and it was just something that they couldn't say no to'. Yet as increased monitoring, control and transparency reduce the ability of units to act independently this stifles subsidiary capacity to take this approach, rendering the 'maverick' approach to initiative taking not only risky but increasingly impractical.

Greater monitoring may have the benefit of reducing agency costs, or the risk of unit managers acting in their own or the subsidiary's interest rather than in the best interests of the organization but it also enhances HQ's ability to access subsidiary information systems and to monitor its "live contacts". As knowledge of subsidiary activities becomes more and more transparent this effectively reduces the exclusivity of the subsidiary's contacts. It also significantly enhances HQ's ability to be involved in key subsidiary network relationships, and to control and co-ordinate these relationships from a distance. A subsidiary's ability to build a strong position for itself within its current location becomes undermined by the HQ's capacity for a takeover of subsidiary relationships. As the scope and capacity of a subsidiary to differentiate their position on the basis of local embeddedness becomes less relevant and impractical we suggest an alternative to local initiative taking by creating and building greater independencies with the parent.

Integration not autonomy-

It may be impossible to anticipate HQ's future plans, but by becoming more aware of HQ strategy the subsidiary has greater potential to become an integral part of future operations. Just as an acting manager is more likely to be approved when a role becomes permanent a subsidiary which is more embedded within HQ activities is more likely to be involved in future endeavours.

A subsidiary strategy that develops the unit's knowledge base in line with stated strategic objectives ensures that any initiatives will be more aligned with existing HQ strategy. We suggest that subsidiary survival and growth may depend on this capacity to comply today whilst positioning for tomorrow, in developing not a *unique* role, but an *active and integrated* role. The level of vertical integration and how subsidiaries interact and coordinate activities with their HQ is a critical component of their structural context and the extent to which they are aligned. Greater integration at the strategic level necessitates the parent to be more supportive; for example through greater integration and a grounded understanding of the subsidiary's local operations and idiosyncrasies *Setanta's* HQ became comfortable with granting a considerable degree of subsidiary flexibility. One HQ based director illustrated how the parent provided a supportive, rather than a dictating role:

> 'Headquarters really should only be giving high-level guidance and sharing its experience to prevent a subsidiary, since its newer, from making the same mistakes that headquarters made…if they're closest to the situation we count on good information to be provided in order to assist where we can, and to help confirm either what *Setanta's* plan is or to give them guidance based on past experience at headquarters'

2) Relational Embeddedness – An alternative to formal monitoring

A subsidiary's credibility within the wider corporate network also influences how it perceived by HQ and is often based on historical performance. A proven capacity to add value will have positive connotations for subsidiary sustainability as it demonstrates an ability to get the task done. We use the term *relational embeddedness* to look beyond the structural attributes of a parent-subsidiary relationship and instead emphasizing the *quality* of that relationship (Moran, 2005). Emerging from the *Setanta* case we identified two interrelated critical aspects of relational embeddedness, trust and consistency of delivery. In *Setanta* we identified how both trust and a consistency of delivery can facilitate a greater depth of relational embeddedness as the need for integration due to the daily handover of client services and a consistent level of customer service led to greater transparency across operations in both locations. As interdependencies grow, higher levels of communication become a necessity rather than an option.

Trust –

Trust as a central feature of any relationship requires that both parties will act in each others best interests, and is usually built up incrementally. Both *Setanta* and their parent spoke of the need for both entities to overcome difficulties of physical and perceived distance to develop mutual trust. One director noted how ‘distance can provide a level of separation and then if you're not communicating then you make up your own idea's as to what's happening over there and they're probably not the right ideas’. Communication is critical in developing trust as HQ needs to be constantly reminded that the subsidiary is acting in line with the organization’s strategy.

In combating the problems ubiquitous to any distant relationship subsidiary managers must attempt to forge a close relationship with their HQ based counterparts. Enhanced communication and relationship building is accredited with not only creating greater efficiencies but also with alleviating concerns about transparency of operations. This realisation was not lost on subsidiary management who adopted an active role in building upon and forging a close relationship with their HQ. One subsidiary manager emphasized his approach to building upon that relationship; ‘I know from my point of view I would encourage a lot more interaction. I would be not so much process driven but more relationship driven’.

Consistency of delivery -

History matters – and the relationship between a subsidiary’s proven capabilities and their potential to extend upon that mandate in the future is acknowledged (Birkinshaw, 1996). As *Setanta* took on more activities and evolved in line with the parent’s strategy a greater degree of responsibility, and ultimately confidence was afforded to the subsidiary. Greater embeddedness in HQ activities, and delivering upon agreed goals position the subsidiary to compete for a wider range of activities. A *virtuous circle of growth* is established as the subsidiary which has proven its ability on previous tasks is then most likely to gain future mandates and the corresponding resources.

3) Knowledge embeddedness

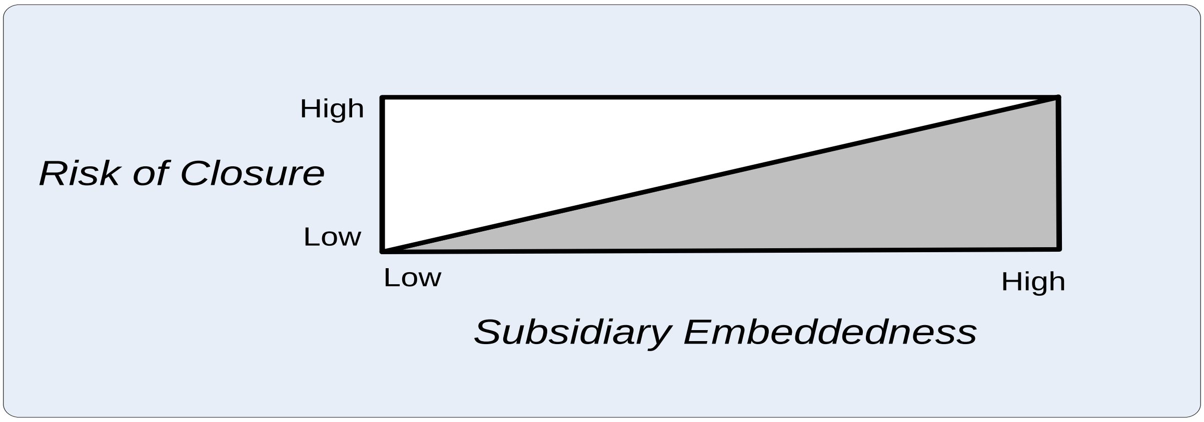
How knowledge is created, integrated and assimilated within an organisation will impact not only on the position that the subsidiary occupies within their network but also on its potential to evolve and modify that position in accordance with external change. We recognise that as subsidiary mandates are ultimately transitory in nature it is necessary to look beyond knowledge flows in categorising subsidiary role and contribution. Markets, being subject to cyclical highs and lows mean that knowledge which was once a source of high value can quickly become redundant. At a global level as cost cutting strategies are becoming more and more prevalent subsidiaries need to bring more to the table than past glories or outdated knowledge repertoires.

Learning Together: Coalescent knowledge creation-

Coalescent knowledge is built through close interaction and an intricate understanding of the needs of all stakeholders. It is a *unified process* aided through open and regular cross functional meetings across all of the business units. An emphasis on communication facilitates greater responses to both problem solving and in seizing opportunities. To learn together a willingness to provide relevant knowledge and a recognition that local solutions may not necessarily be the best solution must be established. This bi-lateral approach to learning requires that existing processes be constantly modified and improved .One director in *Setanta’*s HQ recognised this necessity; ‘no one person has the answer for everything and we work closely together.. there is certainly a bi-lateral learning process.. it’s more collaborative, working together to find that solution’.

The subsidiary must actively demonstrate that it is willing and keen to engage in this role with HQ. In addition HQ needs to recognise that the subsidiary can contribute to learning and that the knowledge generated is directly aligned with its own knowledge base. So unlike current theory which suggests that knowledge from subsidiaries should be distinct and 'unique' we are suggesting that rather it be very much linked to the existing knowledge base of the parent, which aids how well it will be accepted. This does not mean that it will not lead to great change, for example Helfat and Winter (2011) identify how incremental change in wireless telephony resulted in a completely new communication technology. The diagram which follows (Exhibit 1) shows how the risk of subsidiary decline or closure is reduced as subsidiary embeddedness increases.

Exhibit 1.



Convergence between HQ and subsidiary learning – the concluding piece

Without trust and support from the parent a subsidiary's potential to be creative in their solutions would be significantly hindered; not least due to increased levels of monitoring and transparency. Without a proactive and innovative cohort of initiative taking subsidiary managers the potential to seek and seize opportunities also seems implausible. We discussed how a bi-lateral focus on knowledge creation keeps all parties interested; what's good for one is also good for the other. Provided initiative taking is beneficial for all it eases concerns over myopic tendencies or empire building. Trust then cements this relationship, reassuring both parent and subsidiary that they are working together, in unison, towards a common goal. Both parties become confident that their counterparts are acting in a manner that is aligned with their own objectives. The final piece in establishing a fully interdependent position comes through the convergence of HQ and subsidiary knowledge creation; where the subsidiary can demonstrate that they have the capacity to provide creative responses to existing opportunities or escalating environmental change.

Using one last example from our case we illustrate how *Setanta* managed to do just that. Utilising the relative flexibility they enjoyed, *Setanta* chased and secured a major deal with a global client and with a potential revenue stream that dwarfed existing customers. The procedures and processes to handle the level of service required were non-existent and had to be customized and set up from scratch. The potential risks were immediately apparent as noted by one subsidiary manager:

> the reason we won it I think was because of our flexibility, we were so small, we were able to be flexible with them, [but] from our point of view it brought a lot of headaches with it because it was a lot of manual processes and stuff like that and we learned to grow very very fast and get up to speed very fast

The preceding example reflected a significant deferral in the usual practice of HQ carrying out initial testing on a process locally before rolling it our globally. While illustrating an example of their growing confidence in *Setanta* it also presented a scenario where the parent became highly aware of the potential to learn from subsidiary based processes;

> we use them as a baseline for all future ones [similar projects], so we learned from that experience and that implementation how to, I don't want to say cookie cutter it, but how to reproduce what we did, what was done in *Setanta* for any such future implementation we would have of such magnitude

Another director remarked: “really what that did for us was it allowed us to demonstrate that we could sell using a new model… it opened up a whole different way of thinking’. The potential for *Setanta’s* initiative taking was largely attributed to their small size and flexibility of operations. Managers in the subsidiary spoke of the ease at which they could collaborate with their whole unit and how integrated roles facilitated greater understanding of problems and opportunity recognition. This subsidiary context facilitated through bi-lateral learning, flexibility of operations, support and local embeddedness was conducive for the subsidiary to sense and seize immediate opportunities in local European markets. Not only that, but they could also demonstrate their value to the collective organisation. Whilst initiative taking has positive implications in the short term we argue that it may be more sustainable in the long term for subsidiaries to be directly aligned with HQ strategy. This will further enhance trust and confidence in the subsidiary’s ability to deliver. This does not mean that the subsidiary should become a duplicate of the parent rather that it builds upon a mutually interdependent relationship which facilitates incremental growth. Similarly to the telephony example an incremental approach to growth can similarly yield dividends as the Intel example clearly illustrates (Helfat and Winter, 2011).

Conclusion

Subsidiary managers are critically aware of imposing threats which combine to reduce their ability to compete for resources and expand on existing mandates. Our study identifies how subsidiary initiative, often considered as the most powerful tool in a subsidiary’s arsenal against mandate loss may overshadow the importance of aligning with parent directed strategy. We suggest that rather than chasing autonomy through initiatives subsidiary management can redress the balance of power within the MNC by directing their efforts towards building an interdependent relationship with the parent. We identify how *strategic embeddedness* ensures development of subsidiary strategy in line with HQ’s stated objectives, *relational embeddedness* provides a foundation of trust and *knowledge embeddedness* facilitates coalescent knowledge creation and collaborative effort in line with HQ’s strategy and direction.

Greater embeddedness ensures not just an integrated role but an integral one. The need for formal monitoring and controlling is also reduced as operations are highly interwoven and transparent curbing the rent-seeking concerns associated with the ‘maverick’ subsidiary initiator role. As knowledge is created together, in a unified process, the potential to evolve incrementally with the parent may lead to a greater state of subsidiary growth. Just as the Yuan was pegged to the Dollar in ensuring stability in a volatile environment, we suggest it may be better to piggy-back than to go it alone.

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